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Supreme Court of the United States

OCTOBER TERM, 1993

ITT CONSUMER FINANCIAL CORP., AETNA FINANCE CO., ITT LYNDON PROPERTY INS. CO., ITT LYNDON LIFE INS. CO., JOHN M. HIGGINS AND ASAD ZAFARI,
Petitioners,

v.

ABBE KANAREK PATTERSON, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the California Court of Appeal First Appellate District

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PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

May a court apply state-law principles of adhesion and unconscionability to deny enforcement of an arbitration agreement covered under the Federal Arbitration Act, 9 U.S.C. §§ 1, *et seq.*?

LIST OF PARTIES

In addition to the parties listed in the caption, the parties below include respondents Johnny Davis, Ann Ruth Gonsalves, Christine Graham, James P. Jacobs, Thomas Pierce, Zenia M. Velasco, Bruce J. Hodes, Paul Embley, Pamela L. Embley, Donna Wessells, Jorge De La O, and John Lang. Pursuant to Rule 29.1, the corporate petitioners have the following parent corporations and non-wholly owned subsidiaries: ITT Financial Corporation is the parent of ITT Consumer Financial Corporation, ITT Lyndon Property Insurance Company, and ITT Lyndon Life Insurance Company. ITT Consumer Financial Corporation is the parent of Aetna Finance Company. ITT Corporation is the parent of ITT Financial Corporation.

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PETITION FOR WRIT OF CERTIORARI

ITT Consumer Financial Corporation, Aetna Finance Company, ITT Lyndon Property Insurance Company, ITT Lyndon Life Insurance Company, John M. Higgins, and Asad Zafari (collectively "ITT" or "petitioners") hereby petition this Court for a writ of certiorari to review the judgment of the California Court of Appeal, First Appellate District.

OPINIONS AND ORDERS BELOW

The August 12, 1993 order of the Supreme Court of California in this case denying discretionary review

is unreported and reproduced at Appendix ("App.") 1a, *infra*. The California Court of Appeal's May 13, 1993 order denying rehearing is unreported and reproduced at App. 2a. That court's April 19, 1993 opinion is reported at 14 Cal. App. 4th 1659 and reproduced at App. 3a-13a.

JURISDICTION

The Supreme Court of California issued its order denying review in this case on August 12, 1993. The California Court of Appeal decision affirming denial of ITT's motion to compel arbitration is final for purposes of this Court's jurisdiction. *Southland Corp. v. Keating*, 465 U.S. 1, 6-8 (1984) ("For us to delay review of a state judicial decision denying enforcement of the contract to arbitrate until the state-court litigation has run its course would defeat the core purpose of a contract to arbitrate" and "might 'seriously erode federal policy'.").

This petition is being filed within the time permitted by the Rules of this Court as extended by the December 6, 1993 Order of Justice O'Connor (A-370). This Court has jurisdiction over this case pursuant to 28 U.S.C. § 1257(a).

CONSTITUTIONAL PROVISIONS, STATUTES AND RULES INVOLVED

1. The Supremacy Clause of the Constitution, U.S. Const. art. VI, cl. 2, provides, in pertinent part:

> The Constitution, and the Laws of the United States which shall be made in pursuance thereof . . . shall be the supreme Law of the Land; and the judges in every state shall be bound thereby,

> any thing or Laws of any State to the contrary notwithstanding.

2. The Federal Arbitration Act, 9 U.S.C. § 2, provides, in pertinent part:

> § 2. Validity, irrevocability, and enforcement of agreements to arbitrate
>
> A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

STATEMENT OF THE CASE

This case presents the important question whether and under what circumstances a court may invoke state-law contract principles of adhesion and unconscionability to nullify otherwise valid and enforceable arbitration agreements covered by the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1, *et seq.*

The arbitration provisions at issue appear in a series of consumer loan agreements. ITT provides consumer loans, insurance, and related services. Abbe Kanarek Patterson and the other respondents borrowed money from ITT. As part of these transactions, several of the respondents agreed to arbitrate any disputes arising out of the loans and other services.

Respondents executed an "AGREEMENT FOR DISPUTE RESOLUTION," a one-page document separate from the loan agreement. Printed conspicuously in the middle of the page, directly above where each respondent signed the agreement, was a subheading entitled "ARBITRATION," which provided that all disputes arising between respondent and petitioners "shall be resolved by binding arbitration by the National Arbitration Forum, Minneapolis, Minnesota." The entire "Agreement for Dispute Resolution," including the foregoing provision, is printed in large type in upper case letters with each subheading, including **"ARBITRATION,"** in bold face.[1]

Respondents initiated this case by filing a class action against ITT in California state court, asserting various state tort and contract claims with respect to their loan and insurance transactions.[2] ITT petitioned the trial court for an order compelling arbitration of the claims of those respondents who had signed arbitration agreements, and moved for a stay of the pending action in which those respondents had joined.

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[1] Respondent John Lang's arbitration agreement differs slightly but not materially in that it appears in bold face in the body of the loan agreement he executed. The front of Lang's loan agreement provides in bold type, immediately above where Lang signed the agreement: **"You agree to all the terms and conditions on both sides, including binding arbitration."**

The chief difference between Lang's agreement and those of the other respondents is that the former contains a $3,000 jurisdictional carve-out, permitting either party to use small claims court.

[2] Lang subsequently filed a similar action as an individual plaintiff. The *Patterson* and *Lang* cases were heard together because of the common issues presented.

ITT explained that "the transactions underlying the arbitration clause at issue here involved interstate commerce and . . . [that] the Federal Arbitration Act therefore governs the resolution of this dispute." Memorandum of Points and Authorities in Support of Petition for Order Compelling Arbitration and Motion to Stay the Pending Action at 4. ITT argued that the FAA "preempts contrary state laws," and "evidences a 'federal policy favoring arbitration'," *id.* at 3 (quoting *Moses H. Cone Memorial Hosp. v. Mercury Construction Co.*, 460 U.S. 1, 24 (1983)), and that the United States Supreme Court has "directed . . . courts . . . 'rigorously [to] enforce agreements to arbitrate'." *Id.* (quoting *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 226 (1987)).

Respondents did not deny signing the arbitration agreements and did not allege that they were fraudulently induced to do so. They simply asserted that they had not read the arbitration agreements.

The trial court examined the arbitration agreements, concluded that they were unconscionable and therefore unenforceable, and on that basis denied ITT's petition to compel arbitration. App. 15a. The court's conclusion was based on its perception of inadequacies in the arbitration rules and procedures referenced in the arbitration agreements. Even though none of the respondents acknowledged having read the arbitration agreements, or the National Arbitration Forum ("NAF") Rules referenced therein, the court found that the arbitration agreements and the NAF Rules and procedures might lead borrowers to the erroneous conclusion that the arbitration provisions required arbitration hearings to be held in Minnesota (the court acknowledged, however, that the

NAF Rules required arbitration hearings in San Francisco if respondents so requested). The court found also that the NAF Rules regarding waiver of fees in the case of indigency were not understandable, and that the NAF requirement of an affidavit of poverty in order to apply for a fee waiver is "not acceptable to the average borrower." App. 16a. The trial court went on to enjoin ITT from confirming any NAF administrative awards in San Francisco County. App. 17a.

ITT timely appealed the trial court's order to the California Court of Appeal. ITT argued that the FAA, and the strong federal policy favoring arbitration, precluded application of state principles of unconscionability to deny enforcement of the arbitration agreements. Appellant's Opening Brief at 12-16.

The Court of Appeal affirmed. Relying exclusively on California law, the Court of Appeal held that the arbitration agreements were adhesion contracts and were unconscionable. App. 10a. The Court of Appeal affirmed the trial court's determination that some borrowers might mistakenly believe that they must go to Minnesota to arbitrate, and that the NAF Rules regarding waiver of fees in the case of indigency were difficult to understand. Although neither the trial court nor the Court of Appeal made a finding that any respondent was actually misled or otherwise harmed by the arbitration agreements, the Court of Appeal denied enforcement of the agreements based on its speculation that the arbitration procedures might deny a hypothetical borrower an "opportunity to a hearing, much less a hearing held where the contract was signed, unless the borrower has consid-

erable legal expertise or the money to hire a lawyer and/or prepay substantial hearing fees." App. 8a. The Court of Appeal concluded, without any record support, that the NAF's rules and procedures "come perilously close" to denying this theoretical borrower a " 'fair opportunity to present his position.' " App. 9a (quoting *Graham v. Scissor-Tail, Inc.*, 28 Cal. 3d 807, 826, 623 P.2d 165 (1981)).

ITT timely filed a petition for rehearing with the California Court of Appeal. The court summarily denied that petition on May 13, 1993. App. 2a.

ITT timely petitioned for review by the California Supreme Court. In the petition, ITT again asserted that the FAA and federal policy preclude application of state adhesion and unconscionability principles to prevent enforcement of the arbitration agreements. Petition Review for Appellants at 10-16. The California Supreme Court summarily denied the petition for review on August 12, 1993. App. 1a.

REASONS FOR GRANTING THE WRIT

The California Court of Appeal denied enforcement of arbitration agreements on the basis of a state-law determination that arbitration rules and procedures rendered the agreements unconscionable. The California court's manifest hostility toward arbitration is contrary to the strong federal policy in favor of arbitration, and threatens the enforcement of arbitration provisions common in consumer loan and other commercial contracts. The court's application of state law conflicts directly with the rule in the Ninth Circuit that the enforcement of arbitration agreements subject to the FAA is exclusively a matter of federal law. Moreover, the Court of Appeal decision is symp-

tomatic of a larger confusion among the state and federal courts—resulting from inconsistency in this Court's decisions—concerning when, if ever, state-law contract principles may be applied to deny enforcement of arbitration agreements. Review of this case will resolve that confusion.

A. The California Court Of Appeal Decision Conflicts With the Federal Policy Favoring Arbitration And With The Rule In The Ninth Circuit That The Enforcement Of Arbitration Agreements Is Governed Exclusively By Federal Law

The arbitration provisions at issue in this case are part of loan agreements between California residents and a lender incorporated in Delaware, with its principal place of business in Minnesota, engaged in nationwide consumer lending. These provisions are therefore part of contracts involving interstate commerce and thus plainly within the scope of the FAA.[3] The FAA declares that such provisions "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2.

Congress enacted the FAA to reverse the long-standing judicial hostility to arbitration agreements that American courts had adopted from the English

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[3] *See* 9 U.S.C. §§ 1, 2; *Mesa Operating Ltd. Partnership v. Louisiana Intrastate Gas Corp.*, 797 F.2d 238, 243 (5th Cir. 1986) ("[c]itizens of different states engaged in performance of contractual operations in one of those states are engaged in a contract involving commerce under the FAA"); *Snyder v. Smith*, 736 F.2d 409, 418 (7th Cir.) ("it is clear that the 'involving commerce' language must be construed very broadly"), *cert. denied*, 469 U.S. 1037 (1984). *See also Prima Paint v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 401-02 n.7 (1967) (contract need only "relat[e] to interstate commerce").

common law. *Gilmer v. Interstate/Johnson Lane Corp.*, 111 S. Ct. 1647, 1651 (1991); *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 219-20 & n.6 (1985). "Section 2 is a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary." *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24 (1983). State rules antagonistic to arbitration are preempted by the FAA pursuant to the Supremacy Clause. *Southland Corp. v. Keating*, 465 U.S. 1, 16 (1984) ("[i]n creating a substantive rule applicable in state as well as federal courts, Congress intended to foreclose state . . . attempts to undercut the enforceability of arbitration agreements").

This Court has explained that *federal* law applies to the enforcement of arbitration agreements within the scope of the FAA. FAA section 2 "creates a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate." *Moses H. Cone*, 460 U.S. at 25 n.32. Such federal law is applicable in both state and federal courts and creates a strong presumption in favor of the enforcement of arbitration agreements: " 'The preeminent concern of Congress in passing the Act was to enforce private agreements into which parties had entered,' a concern which 'requires that [courts] rigorously enforce agreements to arbitrate.' " *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625-26 (1985) (quoting *Dean Witter*, 470 U.S. at 221). Courts are to apply federal law—and doubts about enforceability "should be resolved in favor of arbitration"—"whether the problem at hand is the construction of the contract language itself or an allegation of waiver,

delay, or a like defense to arbitrability." *Moses H. Cone*, 460 U.S. at 24-25.

In light of these pronouncements, the Ninth Circuit has concluded that the question of enforcement of arbitration agreements under the FAA is exclusively one of federal law. That court rejects outright all application of state-law principles of adhesion and unconscionability. State-law principles may not be invoked to bar arbitrability of disputes under the FAA in the Ninth Circuit. *Mago v. Shearson Lehman Hutton Inc.*, 956 F.2d 932, 934 (9th Cir. 1992) (" 'state law adhesion principles may not be invoked to bar arbitrability of disputes under the [FAA]' ") (quoting *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 286 (9th Cir. 1988)). *See also Bayma v. Smith Barney, Harris Upham and Co.*, 784 F.2d 1023 (9th Cir. 1986); *Hall v. Prudential-Bache Securities, Inc.*, 662 F. Supp. 468, 470 (C.D. Cal. 1987).

The California Court of Appeal decision in this case is squarely inconsistent with the rule articulated and enforced in the federal Circuit that encompasses California. The California court applied state principles of adhesion and unconscionability to defeat the arbitration agreements. The Ninth Circuit would not permit such a result in a case brought in a federal court in California.

Moreover, the California court's application of state law was antagonistic to arbitration. Despite the absence of any evidence that any of the respondents had been defrauded or misled by the agreements, the court refused enforcement because of a perceived imbalance in bargaining power and its determination that borrowers *might* draw the wrong conclusions about the arbitration rules and procedures established

by their contracts. App. 7a. The court was concerned in particular that, despite NAF Rules to the contrary, hypothetical borrowers might believe that they would have to travel to Minnesota for an arbitration hearing,[4] or would have to pay certain fees up front. *Id.* These concerns led the court to the erroneous conclusion that the "NAF's rules and procedures" "come perilously close" to denying the borrower a "fair opportunity to present his position." App. 9a.

This decision represents a return to the "anachronistic judicial hostility to agreements to arbitrate," that the FAA was designed to overcome. *See Mitsubishi Motors*, 473 U.S. at 625 n.14. The Court of Appeal found the arbitration agreements unconscionable precisely because of perceived unfairness in the rules and procedures of the National Arbitration Forum. This Court has rejected similar efforts to undermine the arbitration mechanism. Such "attacks on arbitration 'res[t] on suspicion of arbitration as a method of weakening the protections afforded in the substantive law to would-be complainants,' and as such they are 'far out of step with our current strong endorsement of the federal statutes favoring this method of resolving disputes.' " *Gilmer*, 111 S. Ct.

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[4] As the Court of Appeal acknowledged, the NAF Rules call for a hearing in the federal judicial district where the arbitration agreement was signed. App. 7a. The court nonetheless held the arbitration agreements unconscionable because respondents *might have been* misled into believing that they had to arbitrate in Minnesota. *Id.* But neither the Court of Appeal nor the trial court made a finding that any of the respondents were so misled. Indeed, it would have been impossible for respondents to have made such a claim, because they had not read the arbitration provisions.

at 1654 (quoting *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 481 (1989)).

Had the California court applied federal substantive law, as the Ninth Circuit would, the arbitration agreements here would have been enforced. In line with the federal presumption in favor of arbitration, other courts, both state and federal, have applied federal substantive law to enforce arbitration agreements in standard form contracts despite allegations of unconscionability and unequal bargaining power.[5] *E.g.*,

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[5] Questions of adhesion and unconscionability, at issue in the present case, are questions of contract enforcement. As the California Court of Appeal explained, the question here was not whether an agreement to arbitrate existed, but whether it would be enforced. *See* App. 5a-10a ("Since a contract of adhesion is still fully enforceable, the inquiry then turns to whether enforcement should be denied . . . . We conclude that the arbitration provision in the loan agreement is unconscionable and thus unenforceable."). *See also* Cal. Civ. Code § 1670.5(a) (West 1993) ("If the court as a matter of law finds the contract . . . to have been unconscionable at the time it was made the court *may refuse to enforce* the contract") (emphasis added).

Respondents have argued that the California Court of Appeal ruled on the *existence* of the arbitration agreements. Respondents are wrong, but even if the California Court of Appeal had determined that no arbitration agreements existed, the application of state law to that issue would have placed the California court on one side of a question that has divided the federal Courts of Appeals. *Compare Eassa Properties v. Shearson Lehman Brothers*, 851 F.2d 1301, 1304 n.7 (11th Cir. 1988) ("[w]hile federal law may govern the interpretation and enforcement of a valid arbitration agreement, state law governs the question whether such an agreement exists in the first instance") *with In re Hart Ski Mfg. Co.*, 711 F.2d 845, 846 (8th Cir. 1983) ("federal law governs the question of whether the parties have agreed to arbitrate"). *See also Cook Chocolate Co. v. Salomon*,

Cohen, 841 F.2d at 286; *Coleman v. Prudential Bache Securities, Inc.*, 802 F.2d 1350, 1352 (11th Cir. 1986); *Webb v. R. Rowland & Co.*, 800 F.2d 803, 806-07 (8th Cir. 1986); *David v. Merrill Lynch, Pierce, Fenner and Smith, Inc.*, 440 N.W.2d 269, 274 (N.D. 1989); *Passage v. Prudential-Bache Securities, Inc.*, 727 P.2d 1298, 1302 (Mont. 1986), *cert. denied*, 480 U.S. 905 (1987); *Shotto v. Laub*, 632 F. Supp. 516, 522-23 (D. Md. 1986); *Finkle and Ross v. A.G. Becker Paribas, Inc.*, 622 F. Supp. 1505, 1511-12 (S.D.N.Y. 1985).[6] This Court has asserted the strong federal policy in favor of arbitration in just such cases. *E.g.*, *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 225-26 (1987) (arbitration agreement in form contract between individual customers and large brokerage house); *Gilmer*, 111 S. Ct. at 1651 (arbitration agreement in form contract between individual employee and New York Stock Exchange).

The difference in the law applied to arbitration agreements in the Ninth Circuit and in the courts of California, and the obvious difference in results it produces, will inevitably generate forum shopping and erode the value of arbitration agreements. Those who wish to interdict an arbitration will take advantage of the hostility to arbitration that still flourishes in

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Inc., 684 F. Supp. 1177, 1181 (S.D.N.Y. 1988) (noting the split of authority). Review of this case will allow the Court to clarify this issue and resolve this important split among federal appellate courts.

[6] In fact, courts have enforced under federal law agreements virtually identical to those here, calling for arbitration under the NAF Rules. *E.g.*, *DiCrisci v. Lyndon Guaranty Bank of New York*, 807 F. Supp. 947, 950-51 (W.D.N.Y. 1992); *ITT Consumer Financial Corp. v. McNaughton*, 8 I.E.R. Cases (BNA) 808, 1991 WL 519584 (N.D. Ala. Apr. 12, 1991).

the California courts. Review by this Court is necessary to resolve this division of authority, and reestablish the supremacy of the federal law preserving the validity of arbitration agreements.

B. The Court Of Appeal Decision Is Symptomatic Of Confusion Among State And Federal Courts As To Whether And Under What Circumstances State Law May Be Used To Deny The Enforcement Of Arbitration Agreements

The California Court of Appeal decision in this case not only is contrary to the rule in the Ninth Circuit, but also is inconsistent with decisions of other federal and state courts that have applied federal law to the questions of adhesion and unconscionability of arbitration agreements. *See supra* at 13. Those courts are consistent in applying federal law to arbitration enforcement.[7]

There is, however, an important inconsistency between those other federal and state decisions and the

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[7] *See also Neal v. Hardee's Food Systems, Inc.*, 918 F.2d 34, 37 n.5 (5th Cir. 1990) ("[f]ederal law governs the interpretation and validity of an arbitration clause subject to the Federal Arbitration Act"); *Flink v. Carlson*, 856 F.2d 44, 46 n.2 (8th Cir. 1988) ("the question of what persons are bound by an arbitration agreement concerning interstate commerce is a question of federal law"); *Genesco, Inc. v. T. Kakiuchi & Co.*, 815 F.2d 840, 845 (2d Cir. 1987) ("[i]n enacting the Federal Arbitration Act, Congress created national substantive law governing questions of the validity and the enforceability of arbitration agreements under its coverage"); *Cost Brothers, Inc. v. Travelers Indemnity Co.*, 760 F.2d 58, 60 (3d Cir. 1985) ("questions of the construction of arbitration agreements and their enforceability are governed by federal substantive law"); *Shearson Lehman Hutton, Inc. v. McKay*, 763 S.W.2d 934, 937 (Tex. Ct. App. 1989) ("[t]he issue of whether a party is bound by an arbitration clause is determined by federal law").

decisions of the Ninth Circuit. The Ninth Circuit not only applies federal law to arbitration enforcement, it explicitly rejects *any* application of state law to arbitration agreements. But the other federal and state courts that apply federal law do not rule out the possibility that state law might apply under some circumstances. Moreover, the First and Fourth Circuits *will* apply state law to arbitration agreements if the law is arbitration-neutral. *Securities Industry Ass'n v. Connolly*, 883 F.2d 1114, 1120-21 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990); *Saturn Distrib. Corp. v. Williams*, 905 F.2d 719, 725-26 (4th Cir.), *cert. denied*, 498 U.S. 983 (1990). This division reflects a growing confusion in federal and state courts as to when, if ever, state law may apply to the enforcement of arbitration agreements within the scope of the FAA. That confusion results from a tension in this Court's FAA decisions.

The primary source of the tension is *Perry v. Thomas*, 482 U.S. 483 (1987). FAA section 2 declares that agreements to arbitrate are "valid, irrevocable and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract*" (emphasis added). The Court explained in *Perry* that the validity, irrevocability, and enforceability of arbitration agreements are determined "*as a matter of federal law.*" *Id.* at 492 n.9. This rule is consistent with declarations in *Moses H. Cone* and other FAA cases that section 2 "creates a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate." 460 U.S. at 25 n.32. That rule, standing alone, is consistent with the standard that most federal and state courts have been applying.

The *Perry* Court also observed in dictum, however, that state law may be applicable to arbitration agreements, pursuant to the savings clause of FAA section 2, "*if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." 483 U.S. at 492-93 n.9. Thus, *Perry* suggested that a court may apply general state contract law to an agreement to arbitrate if the state law is neutral in its application to arbitration. "A state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with this requirement." *Id.* The Court explained in particular that the neutrality requirement applies to state-law principles of unconscionability: "Nor may a court rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable." *Id.*[8]

The *Perry* dictum that neutral state-law principles may be applicable to the enforcement of an arbitration agreement appears to conflict with the Court's numerous other pronouncements that the enforcement of an arbitration agreement must be determined as a matter of *federal* substantive law. *See supra* at 9-10; *see also Coenen v. R.W. Pressprich & Co.*, 453 F.2d 1209, 1211 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972) ("[o]nce a dispute is covered by the Act, federal law applies to all questions of interpretation, construction, validity, revocability, and enforceability") (cited with approval in *Moses H. Cone*, 460 U.S. at

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[8] The court below ignored this requirement. The Court of Appeal's decision on unconscionability was not the application of a rule applicable to "any contract," but rather displayed a particular hostility to arbitration based on perceived (but nonexistent) unfairness of arbitration rules and procedures.

25 n.31). As a result, federal and state courts are confused and seriously divided on the question whether state law might be applied under some circumstances to deny the enforcement of arbitration agreements.

Following *Perry*, the First and Fourth Circuits have held that arbitration-neutral state law is applicable to the enforcement of arbitration agreements under the FAA. For example, in *Securities Industry Ass'n*, the First Circuit held that "Massachusetts could . . . pass legislation declaring all contracts of adhesion presumptively unenforceable. . . . Such a rule would apply to arbitration contracts, *among others*. But Massachusetts may not say (judicially, legislatively, or in a regulatory mode) that 'adhesion contracts are especially bad when arbitration is included.'" 883 F.2d at 1121 (citations omitted). And in *Saturn Corp.*, the Fourth Circuit concluded that "[i]f Virginia . . . declared all contracts of adhesion to be presumptively unenforceable, then the statute at issue would not be at odds with general contract law." 905 F.2d at 725-26. *See also W.M. Schlosser Co. v. School Board of Fairfax County*, 980 F.2d 253, 258-59 (4th Cir. 1992) (enforcing Virginia rule that local school board had no authority to arbitrate disputes because the rule "is not an idiosyncratic rule specific to arbitration agreements, but is instead merely an unremarkable part of Virginia's general laws of contract formation") (internal quotations omitted), *cert. denied*, 113 S. Ct. 2340 (1993).

The approach taken by the First and Fourth Circuits is completely inconsistent with the rule in the Ninth Circuit, which determines the enforcement of arbitration agreements exclusively on the basis fed-

eral law, rejecting all application of state-law adhesion and unconscionability principles. Moreover, the decisions of other federal and state courts that have applied federal law to the enforcement of arbitration agreements line up more closely with the Ninth Circuit rule than with that of the First and Fourth Circuits. Although those other courts do not explicitly reject application of state law, as does the Ninth Circuit, neither do those courts look to generally applicable state-law principles in enforcing arbitration agreements. Those decisions have thus complicated further the issue whether and under what circumstances state law may be applied to arbitration agreements.

Review of this case will enable the Court to clarify the growing general uncertainty about the application of state law and to remove the threat that it poses to the utility and efficiency of arbitration agreements under the FAA.

C. By Defeating Federal Policy, The Court Of Appeal Decision Threatens The Continued Viability Of Tens Of Thousands Of Arbitration Agreements

The California Court of Appeal applied state law with a presumption against enforcement of arbitration agreements in cases of perceived imbalance in bargaining power. That decision undermines the future viability of arbitration in California, and in every other State that may be tempted to embrace California's hostility to arbitration.

Thousands of form contracts calling for arbitration of disputes are executed each day in California. Such agreements are commonplace in the purchase of securities, in employment, and in franchising. In industries such as consumer lending and insurance, such

contracts are essential. Without the use of standardized time-tested agreements, repeated consumer loan and insurance transactions simply would not be possible. Moreover, the availability of "the simplicity, informality, and expedition of arbitration," *Mitsubishi Motors*, 473 U.S. at 628, encourages such transactions, and lowers the cost of loans and insurance for consumers. *See Securities Industry Ass'n*, 883 F.2d at 1124 ("Arbitration is a positive good in the eyes of courts and Congress not just because it relieves crowded calendars, but because it relieves an often unnecessary elaboration of social practices."). The California court's antipathy toward arbitration agreements threatens the viability of every such agreement. The court's decision strikes a devastating blow to a form of alternative dispute resolution favored by Congress, and eliminates the efficiencies of the form contract, in the Nation's most populous State.

The potential application of unconscionability rules like those the California Court of Appeal applied here will encourage prolonged and expensive litigation on the collateral issue of arbitrability, contrary to the entire purpose of arbitration: "Contracts to arbitrate are not to be avoided by allowing one party to ignore the contract and resort to the courts. Such a course could lead to prolonged litigation, one of the very risks the parties, by contracting for arbitration, sought to eliminate." *Southland Corp.*, 465 U.S. at 7.

Congress enacted the FAA precisely to eliminate the kind of judicial hostility toward arbitration evinced by the California courts in this case. The FAA, together with this Court's repeated declarations of the "liberal federal policy favoring arbitration agreements," *Moses H. Cone*, 460 U.S. at 24, have en-

couraged agreements to arbitrate as a means of swift, inexpensive dispute resolution. The California Court of Appeal decision calls into question all of these agreements, executed in reliance on the FAA and this Court's decisions. Review by this Court is necessary to reverse this unfortunate ruling and interrupt its damaging consequences.

CONCLUSION

For the foregoing reasons, the Court should grant a writ of certiorari and set the case for plenary review.

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Respectfully submitted,

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